

Message Text

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ACTION ARA-14

INFO OCT-01 ISO-00 CIAE-00 DODE-00 PM-05 H-01 INR-07
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FM AMEMBASSY CARACAS
TO SECSTATE WASHDC 8504

C O N F I D E N T I A L SECTION 1 OF 2 CARACAS 7339

E.O. 11652: GDS
TAGS: EGEN, VE
SUBJECT: VENEZUELA'S ECONOMIC BALANCE SHEET

SUMMARY

1. NEARLY FOUR YEARS HAVE PASSED SINCE THE SUDDEN QUADRUPLING OF PETROLEUM PRICES IN 1973 PROVIDED VENEZUELA WITH AN EXTRAORDINARY OPPORTUNITY TO ACHIEVE MANY OF ITS MOST CHERISHED SOCIAL AND ECONOMIC GOALS. THE SURGE IN PETROLEUM PRICES WAS FOLLOWED ALMOST IMMEDIATELY BY ACCESSION TO THE PRESIDENCY IN EARLY 1974 OF CARLOS ANDRES PEREZ, (CAP), A DYNAMIC LEADER WHOSE LANDSLIDE VICTORY AND DOMINATION OF THE AD PARTY PROVIDED THE POLITICAL MACHINERY FOR RAPID AND DECISIVE ACTION. INDEED, DURING ITS FIRST YEAR IN OFFICE CAP'S ADMINISTRATION APPEARED TO BE A JUGGERNAUT BOUND AND DETERMINED TO REFORM VENEZUELA'S ECONOMIC SYSTEM IN ITS FIVE-YEAR TERM. AFTER MORE THAN THREE YEARS IN OFFICE PROFOUND CHANGES HAVE BEEN WROUGHT, BUT THE ECONOMY IS PLAGUED WITH PROBLEMS WHICH COULD EVENTUALLY HAVE SERIOUS ECONOMIC AND POLITICAL

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REPERCUSSIONS. END SUMMARY.

2. THE MOST STRIKING RESULT OF THE OIL PRICE INCREASE WAS THE UNPRECEDENTED CHANGE IN THE DIMENSIONS OF THE ECONOMY. IN THE PERIOD 1972-75:
(1) GROSS DOMESTIC PRODUCT (CURRENT PRICES) DOUBLED; (2) GOVERNMENT REVENUES TRIPLED; (3)

FOREIGN EXCHANGE INCOME QUADRUPLED (1972-74); AND (4) FOREIGN EXCHANGE RESERVES QUINTUPLED. IN THE PROCESS, HOWEVER, THE ECONOMY BECAME EVEN MORE DEPENDENT ON PETROLEUM (ITS SHARE OF GDP GREW FROM 23 TO 34 PERCENT). MORE SIGNIFICANTLY, WITH PETROLEUM AND IRON NATIONALIZATION THE STATE HAS NOW BECOME THE AXIS AND CENTRAL DRIVING FORCE OF NATIONAL ECONOMIC ACTIVITY. THE STATE NOW ACCOUNTS FOR MORE THAN ONE HALF OF GDP- IT IS THE NATION'S GREATEST PRODUCER, EMPLOYER, FINANCIER, CONSUMER AND INVESTOR.

3. MAURICIO GARCIA ARAUJO, ONE OF VENEZUELA'S MOST RESPECTED PRIVATE ECONOMISTS, RECENTLY OBSERVED THAT DESPITE OBVIOUS FAULTS AND POTENTIAL PROBLEMS ("THREATS"), VENEZUELA'S ECONOMY IS IN A FRANK STATE OF DEVELOPMENT WITH ABUNDANT FISCAL AND FINANCIAL RESOURCES IN AN ATMOSPHERE OF SOCIAL PEACE, DEMOCRACY AND LIBERTY. AMONG POSITIVE FACTORS HE CITED: (1) PETROLEUM NATIONALIZATION WITHOUT "TRAUMA", WITH THE INDUSTRY'S MANAGEMENT TEAM INTACT AND THE ABSENCE OF ANY POLITICAL PRESSURES ON THE INDUSTRY; (2) \$5.5 BILLION IN "SAVINGS" IN THE INVESTMENT FUND OF VENEZUELA; AND (3) VENEZUELA'S EXCELLENT FOREIGN CREDIT RATING.

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4. DESPITE GARCIA'S OPTIMISTIC CONCLUSION, HIS LIST OF WEAKNESSES AND "THREATS" WAS OMINOUS. AMONG WEAKNESSES HE LISTED (1) LACK OF FISCAL DISCIPLINE; (2) INEFFICIENT AND CUMBERSOME PUBLIC ADMINISTRATION; (3) RIGID NATIONAL PRODUCTION UNABLE TO RESPOND ADEQUATELY TO THE INCREASE IN INTERNAL DEMAND, ESPECIALLY FOODSTUFFS; (4) ACCELERATED INCREASE IN IMPORTS RESULTING IN SERIOUS PORT CONGESTION, AND (5) SCARCITY OF QUALIFIED WORKERS AND TECHNICAL PERSONNEL. AMONG SERIOUS THREATS HE LISTED: (1) THE PROSPECT OF FISCAL AND BALANCE OF PAYMENTS DEFICITS AND INFLATION CAUSED BY EXCESS MONETARY LIQUIDITY; (2) INCREASING STATE INTERVENTION IN THE ECONOMY, INCLUDING DISINCENTIVES TO PRIVATE DOMESTIC AND FOREIGN INVESTMENT; AND (3) THE LATENT THREAT OF POLITICAL INTERVENTION IN THE PETROLEUM INDUSTRY.

5. MEASURED IN TERMS OF ITS EXTRAORDINARY OPPORTUNITIES AND AMBITIOUS ECONOMIC GOALS, CAP'S ADMINISTRATION HAS NOT BEEN SUCCESSFUL IN TRANSFORM-

ING VENEZUELA'S ECONOMY. ITS OUTSTANDING
ACHIEVEMENT HAS BEEN THE TRANSITION OF THE PETROLEUM
INDUSTRY TO STATE OWNERSHIP. HOWEVER, THIS ACCOM-
PLISHMENT WAS MORE AN ACT OF PRESERVATION THAN OF
CREATION. ESSENTIALLY, EXCEPT FOR A FEW TOP-
MANAGERS, OIL INDUSTRY PERSONNEL HAVE NOT CHANGED
MUCH AND THE INDUSTRY IS LIVING ON ITS PAST ACHIEVE-
MENTS UNDER PRIVATE MANAGEMENT. THE REAL TEST WILL
COME AS PETROLEOS DE VENEZUELA ATTEMPTS TO ARREST
THE INDUSTRY'S DECLINE THROUGH A COMPREHENSIVE
PROGRAM OF INVESTMENT IN EXPLORATION AND EXPLOI-
TATION OF DEPOSITS REQUIRING MORE SOPHISTICATED
AND EXPENSIVE TECHNIQUES. THE INDUSTRY WILL BE
REQUIRED TO ACCOMPLISH FAR MORE THAN SIMPLY
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DEFEND ITSELF AGAINST THREATS TO ITS AUTONOMY.
VENEZUELA'S ECONOMIC AND POLITICAL STABILITY WILL
DEPEND UPON THE INDUSTRY'S ABILITY TO ASSURE A
SUBSTANTIAL INCOME FLOW FROM THE OIL INDUSTRY
THROUGH THE PUBLIC SECTOR INTO THE ECONOMY.
JUST TO ASSURE THAT THE CURRENT OIL PRODUCTION
LEVEL IS MAINTAINED PETROLEOS DE VENEZUELA WILL
HAVE TO DOUBLE OR TRIPLE CURRENT INVESTMENT IN
THE INDUSTRY (FROM \$500 MILLION TO PERHAPS \$1.5
BILLION ANNUALLY). A STRONG POLITICAL COMMITMENT
WILL BE REQUIRED TO ASSURE THAT THE INDUSTRY
RECEIVES THE REQUIRED MANAGEMENT AUTONOMY, CASH
FLOW, AND OTHER RESOURCES REQUIRED.

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C O N F I D E N T I A L SECTION 2 OF 2 CARACAS 7339

6. "LACK OF FISCAL DISCIPLINE" IS THE MOST SERIOUS FAILING OF CAP'S ADMINISTRATION. DESPITE HIS ADMONITION TO THE NATION THAT VENEZUELA'S FISCAL RESOURCES MUST BE MANAGED WITH A "CRITERION OF SCARCITY", THE NATION'S CURRENT EXPENDITURES BUDGET EXPANDED MORE THAN TWO-FOLD (FROM \$2 BILLION TO \$4.5 BILLION) FROM 1973 TO 1976. MOST OF THE INCREASE (\$1.5 BILLION) WENT FOR INCREASED SPENDING ON EDUCATION, HEALTH, AND ECONOMIC SUBSIDIES- PURPOSES CONSISTENT WITH CAP'S PRIMARY SOCIAL AND POLITICAL GOAL OF SPREADING THE BENEFITS OF VENEZUELA'S WEALTH AMONG A LARGER PORTION OF ITS CITIZENS. HOWEVER, THE WEAK PUBLIC SERVICE SECTOR OF THE GOVERNMENT WAS NOT ABLE TO ABSORB THIS SUDDEN INCREASE EFFECTIVELY. MOREOVER, THE GOV IS NOW "LOCKED IN" TO A HIGHER LEVEL OF CURRENT SPENDING WHICH CANNOT BE REVERSED, ESPECIALLY IN AN ELECTION PERIOD. WITH AN INCREASING SHARE OF ITS CURRENT INCOME ALLOCATED FOR CURRENT SPENDING, THE GOV IS RESORTING TO LARGE-SCALE FOREIGN BORROWING (\$4.5 BILLION PLANNED) TO ASSURE EXECUTION OF ITS PUBLIC INVESTMENT PROGRAM.

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7. CAP'S MOST SERIOUS ECONOMIC PROBLEM IS INFLATION AND INABILITY OF THE ECONOMY TO SATISFY THE LARGE INCREASE IN THE DEMAND FOR GOODS AND SERVICES GENERATED BY THE ENORMOUS INCREASE IN PURCHASING POWER SINCE 1973 (THE MONEY SUPPLY EXPANDED 150 PERCENT). "DESABASTECIMIENTO" (SUPPLY SHORTAGE) HAS BECOME AN APHORISM FOR THE PREVAILING PUBLIC MOOD OF DISCONTENT AND INSECURITY THAT CONTRASTS SO SHARPLY WITH THE ECONOMIC BOOM. THE INCREASE IN LIQUIDITY IS MAINLY A RESULT OF THE UNBRIDLED INCREASE IN PUBLIC SPENDING DESCRIBED ABOVE, BUT THE PROBLEM HAS BEEN GREATLY AGGRAVATED BY MISTAKEN AND OFTEN CONTRADICTIONARY POLICIES WHICH RESTRAINED EXPANSION OF DOMESTIC INVESTMENT AND PRODUCTION. THE MOST SERIOUS OF THESE HAS BEEN THE GOV'S PRICE CONTROL POLICY ON "BASIC" GOODS AND SERVICES. PRICE CONTROLS WERE INHERITED BY CAP FROM THE PREVIOUS ADMINISTRATION, BUT HAVE BEEN EXPANDED AND INTENSIFIED. IRONICALLY, THEY HAVE HAD THEIR MOST DEVASTATING EFFECT ON AGRICUL-

TURAL AND MANUFACTURING INDUSTRIES THAT THE GOV WAS TRYING TO STIMULATE THROUGH IMPORT RESTRICTIONS, GENEROUS CREDIT, AND OTHER INCENTIVES.

8. AS PRODUCTION HAS FALLEN SHORT OF DEMAND, THE ECONOMY HAS BEEN FORCED TO RELY INCREASINGLY ON THE SAFETY VALVE OF INCREASED IMPORTS (UP BY 140 PERCENT SINCE 1973). EVEN THIS REMEDY HAS BECOME UNCERTAIN AS PORTS AND AIRPORTS HAVE BEEN STRAINED BEYOND THEIR CAPACITIES. THE INCREASE IN IMPORTS IS THE PRIMARY FACTOR IN VENEZUELA'S PROSPECTIVE BALANCE OF PAYMENTS DEFICIT.

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9. THE FAILURE OF THE PEREZ ADMINISTRATION TO COME TO GRIPS WITH SERIOUS CURRENT OR POTENTIAL ECONOMIC PROBLEMS IN THE EARLY YEARS WHEN IT HAD THE POWER AND MOMENTUM TO DO SO CANNOT BE REMEDIED NOW. WITH ONLY ONE YEAR AND ONE-HALF REMAINING FOR THE PEREZ ADMINISTRATION, AND THE 1978 PRESIDENTIAL RACE WELL UNDER WAY, SHORT-TERM POLITICAL EXPEDIENCY WILL BE THE RULE. THERE IS VIRTUALLY NO LIKELIHOOD THAT PEREZ WILL IMPLEMENT EFFECTIVE SOLUTIONS (SUCH AS GENUINE TAX REFORM TO BALANCE THE BUDGET AND RESTRAIN DEMAND AND/OR PRICE RATIONALIZATION TO STIMULATE PRODUCTION) IN THE CURRENT POLITICAL ENVIRONMENT (SEE CARACAS 7107). RATHER, THE GOV WILL CONTINUE TO RESORT TO HALF-HEARTED AD HOC MEASURES, MOSTLY ON THE MONETARY SIDE, SUCH AS THE ANTI-INFLATIONARY PACKAGE ANNOUNCED TO FEDECAMARAS ON JULY 10 BY PRESIDENT PEREZ (SEE CARACAS 6891).

10. LACK OF FORESIGHT HAS NOT BEEN THE PRINCIPAL CAUSE OF CAP'S ECONOMIC PROBLEMS. RATHER, HE TOOK ADVANTAGE OF VENEZUELA'S WINDFALL OIL INCOME TO TAKE ON NEW OBLIGATIONS AND RISKS. OIL NATIONALIZATION, RESTRICTIONS ON FOREIGN INVESTMENT, INVESTMENTS IN STATE ENTERPRISES, PRICE CONTROLS, AND INCREASED SPENDING ON SOCIAL PROGRAMS WERE DELIBERATE DECISIONS TO BRING ABOUT SIGNIFICANT CHANGES IN VENEZUELAN SOCIETY. PRESIDENT PEREZ SINCERELY BELIEVES THAT VENEZUELAN DEMOCRACY WILL NOT SURVIVE UNLESS THE GOV CAN DEMONSTRATE SUBSTANTIAL SUCCESS IN REFORMING THE ECONOMIC AND SOCIAL SYSTEM. THE DANGER IS THAT HIS EFFORTS WILL BE PERCEIVED IN THE RELATIVELY NEAR-TERM TO HAVE UNDERMINED VENEZUELA'S PROSPERITY RATHER THAN TO HAVE REFORMED THE SYSTEM.

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11. VENEZUELA'S ECONOMY HAS RETAINED ITS BASIC STRENGTH, BUT THE HALCYON DAYS OF THE ECONOMIC BOOM PRODUCED BY THE OIL PRICE INCREASE ARE ENDING. IN HIS REMAINING ONE AND ONE-HALF YEARS CAP WILL BE HARD PRESSED TO TAKE ANY REALLY EFFECTIVE MEASURES TO CONTROL INFLATIONARY PRESSURES. HE WILL BE UNDER STRONG PRESSURE IN AN ELECTION YEAR TO INCREASE PUBLIC SPENDING RAHTER THAN CUT IT BACK. AFTER THE ELECTION, THE PROBLEM OF BRINGING AN OVER-COMMITTED, INEFFICIENT PUBLIC SECTOR UNDER CONTROL IS LIKELY TO BE CRUCIAL. VENEZUELA'S RESOURCES ARE NOT SUFFICIENT TO MEET ALL DEMANDS BEING PLACED UPON THEM. PRIORITIES (INCLUDING MANY POLITICALLY UNPOPULAR ONES) WILL HAVE TO BE ESTABLISHED IN ORDER TO ACHIEVE THE MOST BASIC GOALS ESTABLISHED IN THE NATIONAL DEVELOPMENT PLAN (PLAN V).

12. IT IS THEREFORE LIKELY THAT PEREZ' ECONOMIC LEGACY WILL POSE SERIOUS PROBLEMS FOR HIS SUCCESSOR. CLEARLY, VENEZUELA WILL CONTINUE TO GIVE TOP PRIORITY TO SUPPORT FOR OPEC AND PETROLEUM PRICE INCREASES TO REDUCE BUDGET AND BALANCE OF PAYMENTS DEFICITS. FURTHER, THE NATIONALIZED OIL INDUSTRY WILL NEED AN ASSURED CASH FLOW TO CARRY OUT ITS INVESTMENT PROGRAM. BEYOND THESE MEASURES, HOWEVER, THE NEXT ADMINISTRATION WILL ALSO FACE THE PROBLEM OF CLEARLY DEFINING THE ROLE OF THE PRIVATE SECTOR WITHIN THE GOVERNMENT'S ECONOMIC PRIORITIES, TO INCREASE PRODUCTIVITY AND GOVERNMENT REVENUES, SINCE VENEZUELA WILL NO LONGER BE ABLE TO RELY ON THE OIL SECTOR AS THE SOLE MOTOR OF ITS ECONOMIC DEVELOPMENT.

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Message Attributes

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